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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1945

No. 317

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

FRANCIS E. TOWER.

BRIEF FOR TAXPAYER AND RESPONDENT

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PETITIONER'S STATEMENT OF FACTS

(In the following brief, references to pages of the Transcript are indicated as T. 2 and references to Petitioner's brief are indicated as B. 2, etc.)

The Tax Court made Findings of Fact which state concisely the undisputed facts in this case. There were no disputed facts. We adopted those Findings in the Circuit Court of Appeals as our Statement of Facts, and relied upon them. We are willing to rely on them here. Petitioner, instead of being satisfied with them, has attempted to restate them, in some instances confusing them. Petitioner has also, in his argument, stated as facts what are merely conclusions found in the Tax Court's opinion (not Findings of Fact) and by which it attempted to justify its decision.

We suggest that this Court treat the Tax Court's Findings of Fact as being a full and fair statement of the facts (T. 10-15).

Petitioner's statement of facts should be amended or corrected, as indicated by the following:

The 190 shares of stock transferred by the taxpayer to his wife as a gift on March 15, 1938, were valued, for gift tax purposes, at $57,114.60 (T. 12). The wife had, since 1935, owned 5 shares of stock (T. 11), making her ownership 195 shares, and her resulting contribution to the capital of the partnership $62,400 as against her husband's contribution of $81,600 and Amidon's contribution of $16,000 (T. 12).

The partnership agreement covered the carrying on of a business theretofore handled by the corporation, viz.: the business of a general foundry and machine shop, and the manufacture and sale of sawmill and road machinery and wood and metal stampings (B. 22).

The partnership agreement provided for the termination of the partnership on the death, retirement or incapacity of any partner, general or limited (B. 24). It provided, also, that a limited partner could sell his interest at will the price to be determined by three appraisers chosen in the usual way, though the remaining limited partners, if any, had the first right to buy (B. 24).

While the general partners had the right to determine the time and manner of distribution of net profits for each year, they were required to "have in mind the necessities and success of future operations of the business" (B. 26, 27). Differences between the partners, if not amicably adjusted, had to be submitted to disinterested arbitrators (B. 27).

In the fiscal years ending August 31 of the years 1938, 1939 and 1940, the withdrawals of earnings by the three partners were as follows (T. 13):

	1938	1939	1940
Mr. Tower	$5,394.74	$10,458.38	$4,973.25
Mr. Amidon	938.96	4,410.18	5,183.08
Mrs. Tower	4,311.66	2,032.80	5,000.00

Petitioner states as a fact that the "profits of the business were in large measure the result of taxpayer's personal services" (B. 15). His reference is to the opinion (not the Findings of Facts) of the Tax Court (T. 18). There is no basis in the evidence for this conclusion, the business not being a personal service enterprise but being a manufacturing enterprise having an average of from 40 to 60 employees and gross assets of approximately $200,000 (T. 11). The taxpayer was the operating head of the business (T. 10).

Petitioner states that the wife became a partner in name and on paper only (B. 16). She had the record title (as shown by the records in the office of the County Clerk) to a 39% interest (later 32½) in the partnership business (Appendix, this brief, Article VI Partnership Certificate), which she had a right to sell at will (B. 24), and which at her death would go to her heirs or legatees (B. 24).

THE APPLICABLE LAW

The Petitioner, in his brief in the instant case (and in the Lusthaus case) recites general principles of law heretofore laid down or recognized by this Court, viz.: that an anticipatory assignment of income to be earned in the future is, from the tax standpoint, ineffective; that an otherwise legally perfect gift of property, but unaccompanied by its economic benefits, does not relieve the donor of the tax on future income; that the income tax law is not so much concerned with refinements of title as with the actual command over the income; that mere formal passage of title alone is not sufficient, especially where family partnerships are involved; that for tax purposes enjoyment of economic benefits marks the real owner; that intra-family transactions should be closely scrutinized to determine whether they are real or sham; and that income from personal services is taxable to him who earns it.

We have at no time disputed any of these principles. We agree with them, and we contend that the Circuit Court of Appeals followed them. We contend also that,

in the light of these tests, there was no warrant in law and no substantial basis in the evidence to justify the Tax Court's decision.

Other equally applicable and equally well settled rules of law might well be summarized, viz.: there is "nothing unlawful or even mildly unethical in the motive of a taxpayer to avoid some portion of the burden of taxation by making a gift of income producing property to his wife (*Marshall v. Comm.*, 57 Fed. 2d 633); *Barach v. Comm.*, 90 Fed (2d) 323; where an interest is acquired in the *partnership capital*, the share of profits belonging to the owner of that capital interest is directly taxable to such owner (*Humphreys v. Comm.* 88 Fed (2d) 430; *Comm. v. Olds*, 60 Fed. (2d) 252); a husband and wife are separate taxpayers and a husband may not be taxed with his wife's income (*Hoeper v. Wisconsin*, 284 U. S. 206); a husband may form a valid partnership with his wife making each partner taxable only for his or her distributive share of the profits (*Comm. v. Olds*, 60 Fed. (2d) 252); this is true of a limited partnership with the wife a limited partner (*Glensder Textile Co.* 46 B. T. A. 176 — Acquiescence by Com'r. Cum. Bul. 1942—1 p. 8); even in a general partnership the management may be lodged in one or more of the partners to the exclusion of others (*Comm. v. Olds*, 60 Fed. (2d) 252); it is of no importance how the wife may have used the income which flowed to her from her own property, for income is taxed with regard to the manner of its receipt and against the owner of the income producing *res*, and not with regard to the manner of expenditure (*Marshall v. Comm.*, 57 Fed. (2d) 634); and even if the sole intent of the parties is to minimize taxes, it does not affect a transaction entered into in good faith and legally consummated (*Gregory v. Helvering*, 293 U. S. 465, 469; *Bullen v. Wisconsin*, 240 U. S. 625, 630; *Superior Oil Co. v. Mississippi*, 280 U. S. 390, 395).

THE ONLY QUESTION BEFORE THIS COURT

A comparison of the Commissioner's Petition for Certiorari and his brief in the instant case might almost lead

one to the conclusion that the granting of the Writ caused the reasons for its application to vanish.

In his Petition for Certiorari the Commissioner alleges that the decision of the Circuit Court of Appeals in the instant case is in direct conflict, or inconsistent, with nine cases in other circuits, viz.: *Earp v. Jones*, 131 Fed. (2d) 292; *Mead v. Comm.*, 131 Fed. (2d) 323; *Waldburger v. Helvering*, 131 Fed. (2d) 598; *Tinkoff v. Comm.*, 120 Fed. (2d) 564; *Doll v. Comm.*, 149 Fed. (2d) 239; *Argo v. Comm.*, 150 Fed. (2d) 167; *Grant v. Comm.*, 150 Fed. (2d) 915; *Strong v. Comm.* 150 Fed. (2d) 915, and *Lusthaus v. Comm.* 149 Fed. (2d) 232. The Commissioner's present brief in the instant case now does not even mention the Earp, Argo, Strong, Waldburger and Tinkoff cases, and cites the Mead, Doll and Grant cases without indicating any definite reason therefor (B. 17). The Lusthaus case, set for argument with the instant case, will be discussed later.

The Commissioner, in his Petition for Certiorari, also alleges that the "question presented in the instant case is an important one in the administration of the tax law" (B. 18) and states that a "decision of this Court in the instant case will serve as a basis for resolving pending, as well as future cases and alleviate the administration and judicial burden which the widespread creation of family partnerships is causing" (Pet. for Writ, p. 19). We now find nothing in Petitioner's brief pertaining to this broad claim on the basis of which he sought from this Court a Writ of Certiorari.

We opposed the granting of the Writ. We contended and we contend now, that the instant case depends on its own facts — *it is not controlled by, and it does not control, the Lusthaus case, or any other family partnership case.*

In the instant case, the Tax Court made Findings of Fact on which we relied in the Circuit Court of Appeals, and on which we rely in this Court. There was no evidence which contradicts those Findings. It is our contention that on the basis of these Findings, the Tax Court's decision was erroneous, as a matter of law, and the de-

cisions of the Circuit Court of Appeals was correct and should be affirmed.

We rest our contention squarely on the law recently laid down by this Court in *Dobson v. Comm.*, 320 U. S. 489; and *Comm. v. Scottish Am. Co.*, 323 U. S. 119; it being our claim that "there was no warrant in the record" and there was not "substantial basis in the evidence" to justify the Tax Court's conclusion. What was said by this Court in *Bingham Trust v. Comm.*, June 4, 1945, Sup. Ct. Adv. Op. Vol. 89, No. 16, p. 1191, is also pertinent as bearing on our claim that in the instant case the Circuit Court of Appeals properly reversed the Tax Court for its error of law in arriving at conclusions having no substantial basis in the evidence.

THE TAX COURT'S DECISION

The Tax Court stated in its opinion that:

> "petitioner did not intend to make a gift of the stock, he did not intend to divest himself of such title, dominion and control of the stock as was necessary to constitute a good and valid gift thereof in praesenti, the transfer was not such that the entire dominion and control of the gift was in the wife" (T. 16), and the husband was "the person who earned the income which was credited to the wife's account" (T. 20).

We challenged government counsel in the Circuit Court of Appeals to find anything in the testimony, anywhere, (or in the Tax Court's Findings of Fact) which bears out this statement of Judge Harron of the Tax Court. It is significant that her decision was not reviewed by the other members of the Tax Court.

Counsel did not meet, and made no attempt to meet, this challenge, though we made it in our briefs and on the oral argument before the Circuit Court of Appeals. When counsel failed to meet the challenge, we challenged the Circuit Court of Appeals to find anything in the record, anywhere, which would bear out Judge Harron's state-

ment or from which an inference could be drawn that there was any "warrant in law" or "substantial basis in the evidence" to support the Tax Court. It will be noted that Judge Martin, in his dissenting opinion in the instant case (T. 65) did not meet, and did not attempt to meet, this challenge.

While we fully realize that a right decision, even though based on a wrong reason, should not be reversed, it is nevertheless significant that in the instant case the reasoning of Judge Harron of the Tax Court, based largely on false premises, is not sound. The opinion of the Circuit Court of Appeals shows that the decision of the Tax Court is not sound, and petitioner's present brief shows that the Solicitor General himself has no faith in some of the Tax Court's conclusions, on which conclusions the Tax Court based its decision.

The Tax Court came to certain legal conclusions which formed the basis of its opinion. We shall discuss each of them briefly, but before doing so we call this Court's attention to the fact that the instant case involves a gift and a partnership organized under the Uniform Limited Partnership Act (set forth in part in appendix to this brief).

This Court, in the Dobson case, has referred to decisions of the Tax Court as being "characterized by substantial uniformity", and as being entitled to great weight and not subject to review if they have "warrant in the record" and "a reasonable basis in law". This Court has also said in a concurring opinion in the more recent Bingham's Trust case that while "the interpretation of tax statutes and their application to particular circumstances are all matters peculiarly within the competence of the Tax Court, on the other hand, constitutional adjudication, determination of local law questions and common law rules of property such as the meaning of a general power of appointment, or the application of the rule against perpetuities, are outside the special province of the Tax Court."

There might well have been included in the latter category questions of what constitutes a gift, a limited part-

nership, or what constitutes the beneficial use, as distinguished from the ownership, of the legal title to real or personal property. These, too, involve common law rules of property, and they involve no "interpretation of tax statutes."

(1) The Tax Court held that the taxpayer did not *intend* to make a gift of the stock or divest himself of such title and control as was necessary to constitute a good and valid gift *in praesenti* (T. 16); that there was no unconditional gift of the stock to the wife, since she could only use it in one way, namely, to place the corporate assets which the stock represented into the partnership (T. 17). The Circuit Court of Appeals effectively answered this point by saying that

> "the conclusion that the transfer was invalid as a gift is rested on the ground that title, dominion and control of the subject matter were not, *in praesenti*, conveyed * * *. A gift is not invalid because of conditions imposed on the donor which are not inconsistent with the immediate vesting of legal title in the donee * * *. Granted, however, that because of the condition, Tower's gift was not complete at the time he gave the shares to his wife, the condition was almost immediately performed. The gift was then both valid and complete, vesting title in the wife to the corporation assets contributed by her to the partnership capital" (T. 62).

(See also, as to the requisites of a valid gift, *Edson v. Lucas*, 40 Fed. (2d) 398).

We might also add that the effect of the Tax Board's conclusion on this point is that the gift was not the stock of the predecessor corporation, but was an interest in the successor partnership. Surely a gift of an interest in the partnership, after its organization, would be no less effective than a gift of the corporate stock because, after all, the test is whether there was a gift of property or capital as distinguished from a gift of profits or personal earnings. The Petitioner does not now claim in his brief that the gift was not *in praesenti* and was conditional. Ap-

parently he has lost faith in this point, which was so vigorously used by the Tax Court in holding against the taxpayer.

(2) The Tax Court held that the taxpayer did not "intend" to make a gift. The Petitioner no longer urges this point, which at all times was purely argumentative and not judicial. A man's intent is usually gathered or inferred from his actions which, it has been said, speak louder than words. His mere statement or claim that he intends to make, that he was making, or that he had made, a gift, would receive very little consideration from this or any other court. In the Circuit Court of Appeals we asked the question, which no one attempted to answer, "what could the taxpayer have done that he did not do to make a bona fide gift!"

(3) The Tax Court concluded that the taxpayer "never intended his wife to have the 190 shares of stock to do with as she pleased * * * upon the dissolution of the corporation, she was not free to sell or otherwise dispose of her share of the corporate assets * * * as a matter of fact, she never received her proportional share of the assets, but they were all transferred, directly to the corporation" (T. 17).

The Petitioner has also abandoned this rather foolish conclusion. Of course, the wife never received her proportionate share of the corporate assets and of course they were all transferred directly to the partnership. The assets of the corporation, by agreement of all the parties and as fully set forth in the partnership agreement (Appendix B, Petitioner's Brief) and partnership certificate (Appendix this brief) were all transferred to the partnership. Even if it had been practicable to do so, what a useless thing it would have been to divide the assets among the three parties in accordance with their ownership of stock, and then have the three parties convey their respective shares of such assets to the partnership.

(4) The Tax Court concluded that because "the gift of the corporate stock was not valid and complete, it follows that the wife made no capital contribution to the partnership, and since she admittedly rendered no services, it

must be held that she was not a bona fide partner" (T. 18). As already indicated, the gift of the stock was complete, and Petitioner now makes no claim to the contrary, except as he claims that the husband did not lose the economic benefit of that which he gave away, which question will be hereinafter discussed.

(5) The Tax Court concluded (in its opinion, not in its Findings of Fact) that the taxpayer "was the person who earned the income which was credited to the wife's account" (T. 20). This conclusion was apparently thought by the Tax Court to be necessary to sustain its decision by bringing this case within the well recognized rule that a man cannot make future returns of income *from personal services* taxable to his wife or to any other than the real earner of such income, viz., the husband. (*Lucas v. Earl*, 281 U. S. 111; *Burnet v. Leininger*, 285 U. S. 136). The Tax Court tried to bring the instant case within the rule of these cases by stating that after the dissolution of the corporation and the organization of the partnership, the business was conducted precisely as it had been before with Francis E. Tower, as the general manager, rendering the same services after as before the change. The Tax Court, in its opinion, politely ignored the facts which the Tax Court found (T. 11) with reference to the character of the business, viz., that it regularly employed from 40 to 60 people in its operations; that it owned assets used in the business having a value of approximately $200,000.00; that the business is comprised of a manufacturing plant containing 30,000 square feet of floor space and producing sawmill machinery and metal stampings for the refrigerator trade (T. 16). That capital was an essential and major income producing factor in the business cannot be questioned.

Petitioner asks for a reversal on the basis of the same conclusion, saying that the "profits were in a large measure the result of his (taxpayer) personal services" (B. 15). There is no Finding of Fact to this effect, there is no evidence to this effect, and all the facts showing the nature of the business are directly to the contrary.

(6) The Tax Court concluded that the wife made no contribution to the partnership, because "the gift of the corporate stock was not valid and complete (T. 18) and as she rendered no personal services she was not a bona fide partner" (T. 18). As already indicated, the gift of the corporate stock was valid and complete, and being valid and complete, the wife contributed (as the result of her original ownership of the 5 shares and her acquisition in 1938 of the 190 shares) $62,400.00 of capital as against the taxpayer's contribution of $81,600.00 and Amidon't contribution of $16,000. (See Certificate of Partnership, Appendix this brief).

Insofar as the rendition of services by the wife is concerned, attention is called to Section 20.54 (See Appendix) of the Michigan Uniform Limited Partnership Law, which expressly provides that:

> "The contribution of a limited partner may be cash or other property *but not services.*"

(7) The Tax Court concluded that the attempt to make a gift was not successful because the husband never really divested himself of "title, dominion and control of the subject of the gift" (T. 16). The Petitioner contends that the taxpayer did not part with the economic benefits of that which he attempted to give away, saying that "it is inconceivable that he considered himself any poorer after the making of the partnership arrangement" (B. 17).

That the parties complied with all legal requirements in making a gift, in organizing a partnership, in conducting a partnership, and in crediting and distributing the profits to the partners in accordance with the partnership agreement and their capital interests cannot be seriously questioned.

What is now urged to justify the conclusion of the Tax Court that the taxpayer did not part with the economic benefits of that which he attempted to give away? What "warrant is there in the record" (*Dobson v. Comm.* supra, *Bingham's Trust v. Comm.*, supra); or "where is there substantial basis in the evidence" (*Comm. v. Scottish Co.*,

supra) for a conclusion that the taxpayer did retain the economic benefits?

The Tax Court, in its opinion, states that as the result of arrangements made about four months *after* the partnership was organized, the husband and Amidon stopped drawing salaries after the first year of the partnership (T. 19) under an agreement whereby Amidon (not related to the family) because of increased duties, was given a 10% increase in his share of the profits, taxpayer and his wife each surrendering 5% of their share to Amidon (T. 20); that after the partnership was formed, the taxpayer still continued to control and actively direct its affairs (T. 18); that for all practical purposes the business was petitioner's business before and after the partnership was organized (T. 19); and that while the wife's shares of the profits were all duly credited to her and she withdrew very substantial portions of them (comparable to her husband's and Amidon's withdrawals), she expended portions of her withdrawals for household and other family purposes.

The Petitioner makes the same general claims and also contends that the control of the partnership having been vested in the taxpayer by virtue of his majority-capital contribution, the taxpayer controlled all of the economic benefits (B. 14, 15). We shall dispose of these points in their order:

(1) During the first year of the partnership the taxpayer, and Amidon, who actively managed the business, drew salaries which were deducted before profits were determined. The agreement later made that, in view of the percentage of profit changes, they would draw no salaries was made not for the benefit of the taxpayer or his wife — it was made in order to satisfy Amidon whose responsibilities and duties were increased as a result of an increase in the volume of business (T. 13). If, as the result of his arrangement, the taxpayer received less than before, then Amidon also received less and it was the wife who received more. If as the result of this arrangement the taxpayer and Amidan received more, the wife would receive less. In either event, it can hardly be claimed that an arrangement made to give Amidon, a stranger to the family, a larger share of the

profits, was made to divert the taxpayer's income to his wife. Even if the result of the taxpayer and Amidon receiving no salary constituted indirectly a diversion of *some* of taxpayer's income to his wife, the Commissioner of internal Revenue was in position to claim that under the tax laws, salaries must be paid to the general partners, and deducted from earnings before such earnings are allocated to all the partners on the basis of their contributions of capital. He never made any such claim and raised no such issue, and it is rather late in the day now, six years later, to make such a claim in an effort to sustain his contention that the taxpayer should be taxed on the entire income.

(2) The taxpayer did continue to control and direct the business of the partnership as he had controlled and directed the business of the corporation. He did this because he held more than a 51% interest of the general partners. He would have had the same control in a corporation (and did in the former corporation) and he would have had the same control in the partnership had his wife's interest as a limited partner been held by a stranger to the family. After all, the test should be whether his legal or equitable rights were any different, insofar as the interest he had given to his wife are concerned, than they would have been if her interest had been held by a stranger.

The control of the partnership exercised by the taxpayer was the control required by the Uniform Limited Partnership Act, which expressly provides that "the contributions of a limited partner may be cash or other property but not services," and which penalizes a limited partner if "he takes part in the control of the business" by making him liable to creditors in the same way as a general partner (Secs. 20.54 and 20.57, Limited Partnership Act — See Appendix). The general partners are entrusted with the management of the business and the limited partner is forbidden to render services or take part in the management of the business.

The trial judge seemed to have the impression that the lawyers and accountants in Michigan were engaged in a conspiracy to defraud the government because they had

advised some of their clients that it would be to their advantage, in the way of lower state and federal taxes, less bookkeeping, and the preparation of fewer reports, to dissolve small corporations and organize limited partnership under the Michigan law.

The Michigan law provides that a group of individuals may do business under various legal entities, viz., (a) as a Corporation (*Mich. Stats. Ann.*, Sec. 21.1 et seq.), (b) as a Partnership Association Limited having the characteristics of a corporation and being so treated by both state and federal tax laws (Sec. 20.91), (c) as a General Partnership (Sec. 20.1) or (d), as a Limited Partnership (Sec. 20.52). That the limited partnership involved in the case at bar is not merely a clever invention of lawyers and accountants is demonstrated by the fact that the Michigan Limited Partnership law in effect in Michigan since 1846, in substantially the present form, is the Uniform Limited Partnership Act now in effect in the same or in modified form in all the states except Louisiana.

Under the agreement of partnership in the instant case, a limited partner has the right to sell his or her interest (Pet. Br. Appendix B, p. 24) the price, in case of dispute, to be fixed by three appraisers, one chosen by the *retiring partner*, one by the *remaining partner*, and the third by the two so selected (Pet. Br. p. 24). In case of dispute between the partners, the dispute, under the agreement, must be referred to arbitration of three disinterested persons, one to be chosen by each party to the dispute, and the third by the two so chosen (Par. 10, Partnership Agreement p. 27 Petitioner's brief).

It will be noted that the husband's control of the partnership was not as broad as was his former control of the corporation because under the partnership agreement any dispute would give rise to arbitration instigated by the wife as a limited partner. This would apply if the general partners voted themselves excessive salaries, though even in the absence of these provisions for arbitration the aid of the courts could always be invoked. Regardless, however, of these remedies available to a limited partner, the control by taxpayer of the partnership was

no different than is the control exercised by a majority stockholder in a corporation through his elected board of directors over the payment of salaries and the distribution of dividends.

When taxpayer made the gift, he was the majority stockholder in a corporation. After he made the gift and after the partnership was organized, he was the majority in interest of the general partners and to that extent exercised the same control as before; subject, however, to the rights given to the limited partners by the agreement as herein indicated. Such control, however, was no different than if his wife's interest had been held by a limited partner who was a stranger to the family. This, after all, is the test that should be applied. What rights she could have asserted, if it became necessary to assert them, to obtain what was due her, should be the criterion in determining whether or not the husband parted with the dominion, control and economic benefit of that which he attempted to give away.

The power to manage is not synonymous with the right to the economic benefits flowing from the property being managed.

Some of the wife's income from the partnership was used by her to build and furnish a cottage, her husband furnishing the balance of the funds. Together they bought war bonds, each contributing one-half of the purchase price. She paid for some of her own clothes, and saved portions of her withdrawals from the partnership, keeping the funds in a safe to which both had access but in which each had a separate box. Taxpayer continued to pay general household bills, as before (T. 14).

The wife at all times had credited to her all, and withdrew from time to time, substantial portions of her share of the profits. She never, at any time, relinquished the interest which had been turned over to her, and her husband at no time exercised any control or supervision over, or any beneficial ownership in, her share of the partnership business or profits. Her partnership interest was assignable, as already pointed out, and it was free from domination or control of her husband. He had

parted with the record title as the result of his prior gift of the stock, and as the result of filing the Certificate of Limited partnership in the office of the County clerk of Montcalm County (Appendix, this brief).

The taxpayer legally did not own, and he could not sell, assign or encumber the interest in the partnership owned by his wife. She *could* sell that interest without his consent, and she could resort to arbitration and to the courts to protect that interest from being diverted or dissipated by him. In case of her death, it went to her heirs or legatees free from his domination and control.

Petitioner claims that "on the record here it is inconceivable that the respondent could have considered himself any poorer after the making of the partnership arrangement" (B. 17).

The taxpayer and his wife were no doubt happily married and had no domestic difficulties, financial or otherwise. Taxpayer may have felt, as most happily married husbands and wives feel, that, in case of need, anything and everything she had she would cheerfully turn over to him. But surely this is not the test to be here applied where we are considering legal rights. Tax laws surely do not penalize husbands and wives who get along well together and who would sacrifice for each other all they possessed in case of need, as against those who, in financial matters, treat each other as strangers.

We contend that the parties here did what they had a legal right to do. They did it in good faith. And they carried out their arrangement in good faith. No one has yet been able to point to anything in the record in this case from which a contrary inference can be drawn.

Surely counsel do not ask this Court to establish a new principle of law and one contrary to the present Revenue Laws which permit (and under the gift and estate tax laws encourage) husbands to make gifts to their wives, which permit husbands and wives to file separate returns, and which permit persons, including husband and wives, to carry on business under various legal entities, including limited partnerships, general partnerships, cor-

porations, and unincorporated associations. And, surely Counsel do not ask this Court to hold that in any case involving a gift from a husband to a wife, or involving a partnership in which a husband and wife are members, the Tax Court can, regardless of the facts, preclude a review by an appellate court under Sec. 240 of the Judicial Code, as amended, (Title 26 Par. 1141—3c, Federal Code Annotated) merely by making a final finding, not based on evidence, that the gift was not bona fide and complete, that the husband retained the economic benefits of that gift, that a partnership was not bona fide, or that the husband — and not capital — earned the income.

It is only on such theories that the decision in the instant case is subject to reversal — theories which have already been expressly repudiated by this Court in the recent case of Bingham's Trust v. Comm. (June 4, 1945) supra, in which this Court said:

> "Hence the statute does not leave the Tax Court as the final arbiter of the issue whether its own decisions of questions of law are right or wrong. That can only be ascertained upon resort to the prescribed appellate process by a consideration of the merits of the point of law involved, and by its decision at the conclusion of the process, not before it begins. The fact that the Court of Appeals below, while accepting the Tax Court's findings of fact, has nevertheless reversed its decision, would seem not to leave the question of law decided so free from doubt that the mandate of the statute could rightly be disregarded on any theory. If review were to be denied in this case, it would be difficult to say that any construction of a taxing statute by the Tax Court would be subject to appellate review."

THE LUSTHAUS CASE

If the Lusthaus case was correctly decided by the Tax Court and the Circuit Court of Appeals for the Third Circuit, it is still not controlling in the instant case. The facts are in no way similar, and the following points in the Lusthaus case might well afford a basis for the claim

that there was "warrant in the record" and "substantial basis in the evidence" to support the Tax Court's decision that the gift and partnership were a sham.

1. The partnership agreement provided that "under no circumstances shall one of the partners sell • • • pledge or encumber • • • his or her interest in the partnership without the written consent of the other" (Lusthaus Transcript 50). The wife therefore acquired from the husband nothing she could sell, thereby not acquiring the usual and essential benefits incident to ownership.

2. The partnership agreement and bill of sale transferring a share of the assets to the wife were signed and delivered June 4, 1940, after five months' profits had been earned (Lusthaus Transcript 48), yet the parties tried to make it retroactive to Jan. 1, 1940, under the claim that they had orally agreed to the transaction prior to that time (Lusthaus Transcript 4). The certificate required by law was actually not filed with the State of Pennsylvania until July 31, 1940 (Resp. Brief Lusthaus p. 4). The parties therefore attempted, among other things, to transfer to the wife 5 months' earnings of the business already accrued and taxable to the husband, earnings which resulted from assets to which the wife did not acquire legal title until after June 5, 1940.

3. The facts in the Lusthaus case were not undisputed. The husband and wife claimed on direct examination that after the formation of the partnership they each drew $50.00 a week and other withdrawals were "divided equally — each getting half" (Lusthaus Transcript 7). The records of the company (produced after the husband's cross-examination in which he again stated that withdrawals were to be in equal portions) showed that in 1940 (the tax year in question) the husband withdrew $4,604.76, and the wife withdrew $59.61 (Lusthaus Transcript 59).

4. While the wife gave eleven notes for $5,000.00 each for part of the purchase price, the notes being payable annually beginning Jan. 1, 1941, she was to pay them "from the profits of the business" (Lusthaus Transcript 15). What was set up as a purchase for a consideration

of $55,000.00, was therefore, in reality, not a purchase at all because she was never expected to pay anything out of her own pocket.

5. In 1941 the husband withdrew $19,198.69 (Lusthaus Transcript 59, 60). The wife's share was $31,871.97, but she withdrew only $16,317.96, all of which went to pay her two notes to Mr. Lusthaus (Lusthaus Transcript 27) and to pay income taxes on her distributive share (Lusthaus Transcript 27). It will be seen that the wife, while claiming to buy an interest in the business for $55,000 (Lusthaus Transcript 39) paid in nothing out of her own pocket and during the first two years of the partnership (only years covered by testimony), she took out nothing. She derived no economic benefit from either her husband's gift or her purchase made with money given her by her husband.

6. The social security tax returns filed by the business in 1939 showed the husband as the sole owner. The returns for 1940 and for the first three months of 1941 still showed the husband as sole owner. Only later returns showed the claimed partnership.

7. The husband claimed on the witness stand that after the partnership was organized, a bank account was opened in the partnership name and both he and his wife signed checks on the partnership account (Lusthaus Transcript 18). On further questioning, he had to admit that it was not until some time in 1943 (three years after the partnership was created) that he gave the bank the right to accept her as a partner and the right to draw checks upon the partnership account (Lusthaus Transcript 19).

THE LORENZ CASE

The petitioner cites *Lorenz v. Commissioner*, 148 Fed. (2d) 527. He claims that because that case was decided adversely to the taxpayer by Judges Martin, Allen and Hamilton of the Sixth Circuit, while the Tower case was decided in favor of the taxpayer by Judges Simon and McAllister with Judge Martin dissenting, it follows that only two out of five judges of the Sixth Circuit sustain our claims in the instant case.

Counsel must be hard pressed to get away from the sound reasoning of the Circuit Court of Appeals in the instant caes if he has to rely on such a mathematical formula. And, in view of the totally different facts in the Lorenz case, there can be no possible application of even the formula.

In the Lorenz case, the Tax Court's Findings of Fact showed (a) that there was no written instrument or gift or assignment of an interest in the business to the wife; (b) the claimed partnership agreement was not filed in any public office; (c) the wife was not, while the husband was, given a drawing account on the partnership books; (d) during the tax year involved, the wife withdrew nothing while the husband withdrew $9,381.11; (e) none of the profit was distributed to the wife, all withdrawals being made by the husband and deposited in his own bank account; and (f) the business was in the main a personal service business employing a nominal capital, it being a machinery sales agency having three salesmen with the husband as the principal salesman (3 *Tax Court* 746).

CONCLUSION

We respectfully submit that the decision of the Circuit Court of Appeals should be affirmed. There is no warrant in the record and there is no evidence in the record to sustain the decision of the Tax Court. Petitioner has been unable to point out — and he does not point out — anything in the record indicating that the parties in the instant case did not, in good faith, do what they had a legal and moral right to do; and that they did not carry out fully and honestly their agreement of copartnership with a proper division of the profits to the persons entitled thereto. This Court should not deny to the taxpayer the right which the statute gives him to have his case reviewed by the Circuit Court of Appeals, and to have the latter Court reverse the decision of the Tax Court if there is no warrant and no evidence in the record to support the Tax Court's decision.

The Petitioner, in effect, asks this Court to hold that the decision of the Tax Court is right because it is the de-

cision of the Tax Court; that because the parties entered into an agreement which reduces their taxes, that arrangement must be held fraudulent; and that a partnership between a husband and wife is a sham and must be ignored for tax purposes.

The petitioner, in effect, asks this Court to hold that every assignment of income-producing property from a husband to his wife or from a father to his children should be disregarded as an anticipatory arrangement to shift income within the family group. This goes much farther than the established principle that transactions between members of the family should be carefully scrutinized to determine whether they are genuine. It, in effect, nullifies all gifts between family members by regarding the family as a unit and by regarding transfers within the family as ineffective. It attempts to establish by judicial action the result which Congress refused to enact by statute — that is, to regard the husband and wife as a single tax unit.

We respectfully submit that the instant case is governed by the following well known and well settled principles of law which this Court must either recognize or reject, viz.:

(1) Under all Revenue Acts from the beginning, the husband and wife have been regarded as separate taxpayers and a husband may not be taxed with his wife's income. Although transactions between husband and wife may be carefully scrutinized, in the absence of any showing of irregularity, there are no separate rules of law which are applicable to husband and wife as distinguished from other taxpayers.

(2) A husband may make gifts of property to his wife and thereafter he is not taxable on the fruits and profits from the property transferred. Such property may include shares of stock and transfer of the stock of record is prima facie proof that the stock has been transferred.

(3) A husband and wife who are stockholders in a corporation may elect to change the form of business organization, dissolve the corporation, and form a partnership. The fact that taxes may be saved by such a reorganization does not cause it to be an invalid device.

(4) The partnership may be a limited partnership to which the wife contributes no services provided capital is an important income producing factor. The wife may delegate the management of the partnership to the other partner, and in a limited partnership, the management must be delegated to the general partners.

(5) It is of little importance for tax purposes how the wife may use the income which flows to her from her own property, for income is taxed against the owner of the income producing *res* and not with regard to the manner of its expenditure.

Respectfully submitted,

OSCAR E. WAER,
Attorney for Taxpayer and Respondent.

Applicable Provisions of Michigan Uniform Limited Partnership Act (Act 110 Public Acts of 1931, Chap. 192 — Sections 20.51-20.81, Mich. Stats. Ann., superseding Revised Stats. 1846, Chap. 33).

Sec. 20.54. The contributions of a limited partner may be cash or other property, but not services.

Sec. 20.57. A limited partner shall not become liable as a general partner unless, in addition to the exercise of rights and powers as a limited partner, he takes part in the control of the business.

Sec. 20.59. A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partner, a general partner or all of the general partners have no authority to (a) do any act in contravention of the certificate, (b) do any act which would make it impossible to carry on the ordinary business of the partnership • • • (d),possess partnership property, or assign their rights in specific partnership property, for other than a partnership purpose.

Sec. 20.60 (1) A limited partner shall have the same rights as a general partner to (a) have the partnership books kept at the principal place of business of the partnership, and at all times to inspect and copy any of them (b) have on demand true and full information of all things affecting the partnership, and a formal account of partnership affairs whenever circumstances render it just and reasonable, and (c) have dissolution and winding up by decree of court.

(2) A limited partner shall have the right to receive a share of the profits or other compensation by way of income, and to the return of his contribution as provided in sections fifteen (15) and sixteen (16).

Sec. 20.66. Subject to the provisions of paragraph (1) a limited partner may rightfully demand the return of his contribution (a) on the dissolution of the partnership or (b) when the date specified in the certificate for its re-

turn has arrived * * * A limited partner may have the partnership dissolved and its affairs wound up when he rightfully but unsuccessfully demands the return of his contribution, or the other liabilities of the partnership have not been paid, or the partnership property is insufficient for their payment as required by paragraph (1a) and the limited partner would otherwise be entitled to the return of his contribution.

Sec. 20.70. The retirement, death, or insanity of a general partner dissolves the partnership unless the business is continued by the remaining general partners under a right so to do stated in the certificate or with the consent of all members.

Sec. 20.71. On the death of a limited partner his executor or administrator shall have all the rights of a limited partner for the purpose of settling his estate, and such power as the deceased had to constitute his assignee a substituted limited partner. The estate of a deceased limited partner shall be liable for all his liabilities as a limited partner.

APPENDIX

LIMITED PARTNERSHIP CERTIFICATE OF R. J. TOWER IRON WORKS
(Filed Aug. 31, 1937)

Pursuant to the provisions of Act No. 110 of the Public Acts for the State of Michigan for 1931, the undersigned hereby form a limited partnership as follows:

ARTICLE I

The name of the partnership is R. J. TOWER IRON WORKS.

ARTICLE II

The character of the business to be conducted is that of a general foundry and machine shop, the manufacturing and selling of sawmill machinery, road machinery, stampings of steel and articles composed of metal and wood, or metal or wood alone, and any business incidental thereto.

ARTICLE III

The location of the principal place of business is the City of Greenville, in Montcalm County, Michigan.

ARTICLE IV

The names and places of residence of the partners, and the classification thereof, as as follows:

Francis E. Tower, General Partner, Greenville, Michigan.

Harvey A. Amidon, General Partner, Greenville, Michigan.

Hazel I. Tower, Limited Partner, Greenville, Michigan.

ARTICLE V

The partnership shall exist for the term of twenty years unless sooner terminated, as it may be, by a decision of a majority in interest and ownership of the total partner-

ship capital, including the capital interest of the limited partner and the assigns of such limited partner.

ARTICLE VI

The contributions of the several partners to the partnership capital are determined as follows:

All of the plant and equipment, and all of the inventories and property of every kind and nature heretofore belonging to and comprising a part of the business of the corporation known as the R. J. Tower Iron Works, which corporation's term of existence expired on August 30, 1937, are being taken over by this partnership subject to all of the existing indebtedness of said corporation. It is agreed that the net assets of the said R. J. Tower Iron Works, a Michigan corporation, at the time of the dissolution, at a fair value, totaled the sum of $160,000; that such sum is the contribution of the partners to the capital of the partnership; that the agreed value of such capital and property contributed by Hazel I. Tower as a limited partner is the sum of $62,400; that the agreed value of such capital and property contributed by Francis E. Tower as a general partner is the sum of $81,600; that the agreed value of such capital and property contributed by Harvey A. Amidon as a general partner is the sum of $16,000.

ARTICLE VII

Each of the partners shall receive, by reason of his or her contribution, such share of the profits of the partnership business, and bear such share of the losses of the partnership as his or her aforesaid contribution to the partnership capital bears to the total of the partnership capital, and the interest and share of each partner, both general and limited, in the partnership capital shall at all time be the same proportionate share thereof, whether the partnership capital hereafter increases or diminishes in amount or value as a result of business operations. It is intended and agreed, however, that the general partners shall receive salaries from the partnership for the services rendered by them in the active management of the business

of the partnership, and that such salaries shal be deducted from the earnings of the partnership before determining the profits to be distributed to all of the partners. The limited partner shall in no event be liable for or subject to any loss or losses whatsoever in excess of the amount of the capital contributed by her to the capital of the partnership.

ARTICLE VIII

The partnership shall not be dissolved by the death, retirement or incapacity to act of any general partner, or by the sale or transfer of his interest therein; but in any such event the remaining general partner or partners shall continue the business.

ARTICLE IX

The general partners may, at any time by unanimous agreement, admit additional limited partners upon such terms, not more favorable than or accorded the present limited partner, as they may determine and agree upon.

ARTICLE X

The general partners may at any time admit additional general partners by unanimous agreement, upon such terms as will in no manner prejudice or be detrimental to the rights and interest of the limited partner or partners, and any limited partner may become a general partner with the consent of all the general partners.

Francis E. Tower.
Harvey A. Amidon.
Hazel I. Tower.

STATE OF MICHIGAN,
ss.
COUNTY OF KENT.

On August 28, 1937, Francis E. Tower, Harvey A. Amidon and Hazel I. Tower being first duly sworn did each

depose and say that he has read the foregoing certificate of limited co-partnership subscribed by him, that he knows the contents thereof and that the same are true, and each severally acknowledged the same to be his free act and deed for the purposes therein stated.

Oscar E. Waer,
Notary Public, Kent County, Mich.

My commission expires Dec. 13, 1938.

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SUPREME COURT OF THE UNITED STATES.

No. 317.—October Term, 1945.

Commissioner of Internal Revenue, Petitioner, vs. Francis E. Tower.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[February 25, 1946.]

Mr. Justice Black delivered the opinion of the Court.

The Commissioner of Internal Revenue determined that respondent's wife had in her income tax returns for 1940 and 1941 reported as her earnings, income that actually had been earned by her husband but had not been reported in his returns. A deficiency assessment was consequently levied against the respondent by the Commissioner. The particular earnings involved were a portion of net income attributed to a partnership, to which, according to its records, 90 per cent of the capital had been contributed by respondent and his wife, of this, 51 per cent had been contributed by the respondent and 39 per cent by his wife. If as respondent asserts, the circumstances surrounding the formation and operation of this partnership were such as to bring it within the meaning of Sections 181 and 182 of Title 26 of the United States Code, then the respondent and his wife are liable only for their respective individual share of the business' income. These sections provide that partners are liable for taxes on partnership income only in their "individual capacity" and that each partner shall report "his distributive share of the ordinary net income . . . of the partnership." But Section 11 of Title 26 of the United States Code levies a tax on the "net income of every individual", and the "net income" is required to be computed on the basis of "gross income" as defined in Section 22(a), which broadly includes all earnings of any individual from "any source whatever". And we have held that the dominant purposes of all sections of the revenue laws, including these, is "the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid." *Helvering* v. *Horst*, 311 U. S. 112, 119. The basic question in deciding whether the

Commissioner's deficiency assessment was proper, is: Was the income attributed to the wife as a partner income from a partnership for which she alone was liable in her "individual capacity", as provided by 26 U. S. C. §§ 181 and 182, or did the husband, despite the claimed partnership actually create the right to receive and enjoy the benefit of the income, so as to make it taxable to him under Sections 11 and 22(a)?

The respondent asked the Tax Court to review and redetermine the Commissioner's deficiency assessment, insisting that the income in question was not the respondent's but his wife's share in a partnership. The Commissioner urged in the Tax Court that the wife had contributed neither services nor capital to the partnership and that her alleged membership in the partnership was a sham. Respondent admitted that she had not contributed her services, but contended that she had made a contribution of capital as shown by the amount attributed to her on the partnership books and that she was a bona fide partner. Her alleged contribution consisted of assets which the husband claimed to have given to her three days before the formation of the partnership.

The Tax Court concluded that the respondent had never executed a complete gift of the assets which his wife later purportedly contributed to the partnership; that after the partnership was formed respondent continued to manage and control the business as he had done for many years before; that his economic relation to the portion of the partnership income which was attributed to his wife was such that it continued to be available to be used for the same purposes as before, including ordinary family purposes; that the effect of the whole partnership arrangement, so far as it involved respondent and his wife was a mere reallocation of respondent's business income within the family group; and that the dissolution of the corporation and the subsequent formation of the partnership fulfilled no business purpose other than a reduction of the husband's income tax. The Tax Court concluded that this family partnership income was in fact earned by the husband; that there was no real partnership between petitioner and his wife for purposes of carrying on a business enterprise; that the wife received a portion of the income "only by reason of her marital relationship", and held that the entire income was therefore, taxable to the respondent under 26 U. S. C. § 22(a). 3 T. C. 396. The Circuit Court of Appeals for the Sixth Circuit

reversed. 148 F. 2d 388. The Circuit Court of Appeals for the Third Circuit Court sustained a holding by the Tax Court, based on facts in all material respects similar to the ones in this case, that all the income from a husband-wife partnership was taxable income of the husband under 26 U. S. C. § 22(a). *Lusthaus* v. *Commissioner*, 149 F. 2d 232. Other Circuit Courts of Appeals have also sustained similar holdings by the Tax Court.[1] As is indicated by numerous Tax Court decisions, attempts to escape surtaxes by dividing one earned income into two or more through the device of family partnerships have recently created an acute problem.[2] Because of the various views expressed as to controlling legal principles in the decisions discussing such arrangements, we granted certiorari both in this and the *Lusthaus* case.

A statement of some of the pertinent facts shown by the record and on which the Tax Court based its conclusion will cast some light on the problem. Broadly speaking, these facts follow a general pattern found in many of the "family partnership" cases. The business here involved, R. J. Towers Iron Works, is located in Greenville, Michigan and has manufactured and sold sawmill machinery and wood and metal stampings. Respondent's participation in the business dates back twenty-eight years. He has managed and controlled the company since the death of his father in 1927. During the tax years in question the business had forty to sixty employees on its pay roll. From 1933 to 1937 the business was operated as a corporation. The respondent was the president of the corporation and owned 445 out of the 500 shares outstanding,[3] his wife was vice president and owned five shares, and one Mr. Amidon was the secretary, owning twenty-five shares. These three also constituted the Board of Directors, and while Towers managed the corporate affairs, Amidon acted as bookkeeper. Mrs. Towers performed no business services.

In 1937 substantial profits pointed to increased taxes. Respondent's attorney and his tax accountant advised him that dissolution of the corporation and formation of a partnership with

[1] Earl v. Jones, 131 F. 2d 292 (C. C. A. 10th); Mead v. Commissioner, 131 F. 2d 323 (C. C. A. 5th); Argo v. Commissioner, 150 F. 2d 67 (C. C. A. 5th); Lorenz v. Commissioner, 148 F. 2d 527 (C. C. A. 6th).

[2] See cases collected in Paul, Partnerships in Tax Avoidance, 13 G. W. L. Review, 121.

[3] For about six months immediately following incorporation the respondent owned only 425 shares.

his wife as a principal partner, would result in tax savings and eliminate the necessity of filing various corporate returns. The suggested change was put into effect. August 25, 1937, respondent transferred 190 shares of the corporation's stock to his wife on the condition that she place the corporate assets represented by these shares into the new partnership. Respondent, treating the stock transfer to his wife as a gift valued at $37,000.00, later paid a gift tax of $213.44. Three days after the stock transfer the corporation was liquidated, a limited partnership was formed and a certificate of partnership was duly filed for record as required by Michigan law. According to the books, the value of the donated stock became the wife's contribution to the partnership. The formation of the partnership did not in any way alter the conduct of the business, except that both Amidon and Tower ceased to draw salaries. By an agreement made shortly thereafter, a readjustment was made in the amount of profits each partner was to receive, under which Amidon's share became the equivalent of, if not more than, the amount of the salary he had previously drawn. Under the partnership agreement the respondent continued to have the controlling voice in the business, as to purchases, sales, salaries, the time of distribution of income, and all other essentials. Respondent's wife, as a limited partner, was prohibited from participation in the conduct of the business. So far as appears, the part of her purported share of the partnership business she actually expended was used to buy what a husband usually buys for his wife such as clothes and things for the family or to carry on activities ordinarily of interest to the family as a group.

We are of the opinion that the foregoing facts were sufficient to support the Tax Court's finding that the wife was not a partner in the business.[4] A partnership is generally said to be created when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and losses.[5] When the existence of an alleged partnership arrangement is chal-

[4] Since the Commissioner had determined that the wife was not really a partner, the burden rested upon the respondent to produce sufficient evidence to convince the Tax Court that the Commissioner's determination was wrong. Welch *v.* Helvering, 290 U. S. 111; Commissioner *v.* Heininger, 320 U. S. 467, 475.

[5] Ward *v.* Thompson, 22 How. 330, 333, 334; Meehan *v.* Valentine, 145 U. S. 611, 618.

lenged by outsiders, the question arises whether the partners really and truly intended to join together for the purpose of carrying on business and sharing in the profits or losses or both. And their intention in this respect is a question of fact, to be determined from testimony disclosed by their "agreement, considered as a whole, and by their conduct in execution of its provisions." *Drennen* v. *London Assurance Company*, 113 U. S. 51, 56; *Cox* v. *Hickman*, 8 H. L. Cas. 268. We see no reason why this general rule should not apply in tax cases where the government challenges the existence of a partnership for tax purposes.[6] Here the Tax Court, acting pursuant to its authority in connection with the enforcement of federal laws, has found from testimony before it that respondent and his wife did not intend to carry on business as a partnership. This finding of fact, since supported by evidence, is final. *Commissioner* v. *Heininger*, 320 U. S. 467, 475; *Dobson* v. *Commissioner*, 320 U. S. 489. The decision of the Tax Court was therefore correct unless, as respondent contends, the Tax Court erroneously disregarded or improperly applied certain legal principles.

Respondent contends that the partnership arrangement here in question would have been valid under Michigan law and argues that the Tax Court should consequently have held it valid for tax purposes also. But the Tax Court in making a final authoritative finding on the question whether this was a real partnership is not governed by how Michigan law might treat the same circumstances for purposes of state law. Thus, Michigan could and might decide that the stock-transfer here was sufficient under state law to pass title to the wife, so that in the event of her death it would pass to whatever members of her family would be entitled to receive it under Michigan's law of descent and distribution. But Michigan cannot by its decisions and laws governing questions over which it has final say, also decide issues of federal tax law and thus hamper the effective enforcement of a valid federal tax levied against earned income. The contention was rejected in *Lucas* v. *Earl*, 281 U. S. 111. There husband and wife made an agreement for joint ownership of the husband's future income. Assuming that the husband's future earnings were under California law considered as

[6] What would be the effect for tax purposes should taxpayers after holding themselves out as a partnership later challenge the existence of the partnership, is a question not here presented. See Higgins *v.* Smith, 308 U. S. 473, 477.

partly owned by the wife, this Court refused to accept the state's concept of the effect of the agreement which would have reduced the federal tax on income actually earned by the husband. And in *Helvering* v. *Clifford*, 309 U. S. 331, 334-335, we held that the purpose of 26 U. S. C. § 22(a) to tax all income against the person who controlled its distribution could not be frustrated by family group arrangements, even though the distribution arrangements were valid for state law purposes. The statutes of Congress designed to tax income actually earned because of the capital and efforts of each individual member of a joint enterprise are not to be frustrated by state laws which for state purposes prescribe the relations of the members to each other and to outsiders. Cf. *Burke-Waggoner Assn.* v. *Hopkins*, 269 U. S. 110, 114.

Respondent contends that the Tax Court's holding that he is taxable for the profits from the partnership is contrary to a principle long recognized by this Court that "The legal right of a taxpayer to decrease the amount of what would otherwise be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." *Gregory* v. *Helvering*, 293 U. S. 465, 469. We do not reject that principle. It would clearly apply, for example, in a situation where a member of a partnership, in order to keep from paying future taxes on partnership profits and in order to get into a lower income tax bracket sells his interest to a stranger relinquishing all control of the business. But the situation is different where the taxpayer draws a paper purporting to sell his partnership interest even to a stranger, though actually he continues to control the business to the extent he had before the "sale" and channels the income to his wife. Then a showing that the arrangement was made for the express purpose of reducing taxes simply lends further support to the inference that the husband still controls the income from his partnership interest, that no partnership really exists and that earnings are really his and are therefore taxable to him and not to his wife. The arrangement we are here considering was of the type where proof of a motive to reduce income taxes simply lent further strength to the inference drawn by the Tax Court that the wife was not really a partner. See Paul, Selected Studies in Federal Taxation, 2d series, pp. 293-300. To rule otherwise would mean ordering the Tax Court to shut its eyes to the realities of tax avoidance schemes.

Respondent urges further that the Tax Court erroneously con-

cluded that the gift was ineffective for tax purposes because it was conditional and therefore incomplete. The government defends the Tax Court's conclusion. We do not find it necessary to decide this issue. The question here is not simply who actually owned a share of the capital attributed to the wife on the partnership books. A person may be taxed on profits earned from property, where he neither owns nor controls it. *Lucas* v. *Earle*, *supra*.[7] The issue is who earned the income and that issue depends on whether this husband and wife really intended to carry on business as a partnership. Those issues cannot be decided simply by looking at a single step in a complicated transaction. To decide who worked for, otherwise created or controlled the income, all steps in the process of earning the profits must be taken into consideration. See *Commissioner* v. *Court Holding Co.*, 324 U. S. 331, 334. Of course, the question of legal ownership of the capital purportedly contributed by a wife will frequently throw light on the broader question of whether an alleged partnership is real or pretended. But here the Tax Court's findings were supported by a sufficient number of other factors in the transaction, so that we need not decide whether its holding as to the completeness of the gift was correct. Cf. *Helvering* v. *Hallock*, 309 U. S. 106, 117, 118; *Burnet* v. *Wells*, 289 U. S. 670, 677.

There can be no question that a wife and a husband may, under certain circumstances, become partners for tax, as for other, purposes. If she either invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services, or does all of these things she may be a partner as contemplated by 26 U. S. C. §§ 181, 182. The Tax Court has recognized that under such circumstances the income belongs to the wife.[8] A wife may become a general or a limited partner with her husband. But when she does not share in the management and control of the business, contributes no vital additional service, and where the husband purports in some way to have given her a partnership interest, the Tax Court may properly take these circumstances into consid-

[7] Under some circumstances income has been held taxable to a person even when he does not own or control it. United States *v.* Joliet & Chicago R. Co., 315 U. S. 44, 46.

[8] See e. g. Croft *v.* Commissioner, T. C. No. 1432, decided February 9, 1944.

eration in determining whether the partnership is real within the meaning of the federal revenue laws.

It is the command of the taxpayer over the income which is the concern of the tax laws. *Harrison* v. *Schaffner*, 312 U. S. 579, 581, 582. And income earned by one person is taxable as his if given to another for the donor's satisfaction. *Helvering* v. *Horst*, 311 U. S. 112, 119. It is for this reason, among others, that we said in *Helvering* v. *Clifford*, *supra*, 335, that transactions between husband and wife calculated to reduce family taxes should always be subjected to special scrutiny. For if under circumstances such as those now before us, the end result of the creation of a husband-wife partnership, though valid under state laws, is that income produced by the husband's efforts continues to be used for the same business and family purposes as before the partnership, failure to tax it as the husband's income would frustrate the purpose of 26 U. S. C. § 22(a). By the simple expedient of drawing up papers, single tax earnings cannot be divided into two tax units and surtaxes cannot be thus avoided.

Judged by the actual result achieved, the Tax Court was justified in finding that the partnership here brought about no real change in the economic relation of the husband and his wife to the income in question. Before the partnership the husband managed, controlled, and did a good deal of the work involved in running the business, and he had funds at his disposal which he either used in the business or expended for family purposes. The wife did not contribute her services to the business and received money from her husband for her own and family expenses. After the partnership was formed the husband continued to control and manage the business exactly as he had before. The wife again took no part in the management or operation of the business. If it be said that as a limited partner she could not share in the management without becoming a general partner the result is the same. No capital not available for use in the business before was brought into the business as a result of the formation of the partnership. And the wife drew on income which the partnership books attributed to her only for purposes of buying and paying for the type of things she had bought for herself, home and family before the partnership was formed. Consequently the result of the partnership was a mere paper reallocation of income among the family members. The actualites of their relation to the income

did not change. There was, thus, more than ample evidence to support the Tax Court's finding that no genuine union for partnership business purposes was ever intended and that the husband earned the income. Whether the evidence would have supported a different finding by the Tax Court is a question not here presented.

Reversed.

The CHIEF JUSTICE and Mr. Justice REED dissent for the reasons stated in their dissenting opinion in *Lusthaus* v. *Commissioner*, No. 263, decided today.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

SUPREME COURT OF THE UNITED STATES.

No. 317.—October Term, 1945.

Commissioner of Internal Revenue, Petitioner, vs. Frances E. Tower.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[February 25, 1946.]

Mr. Justice Rutledge, concurring.

I agree with the result and with the Court's view that the evidence was amply sufficient to sustain the Tax Court's findings and conclusions in this case and in *Lusthaus* v. *Commissioner*, No. 263. I candor forecasting to add, however, that in my judgment the decisions' effect is to rule that in situations of this character the formation of a limited partnership under state law between husband and wife, with the latter as the limited partner, following immediately upon the husband's donation to the wife of a share in the assets of the business previously and afterwards conducted by him and conditioned upon her leaving the assets in the business does not, as a matter of federal tax law, accomplish the formation of a partnership sufficient to relieve the husband of tax liability for the income derived after the transfer from use in the business of the share thus donated to the wife. In other words, I think that as a matter of law the taxpayers in these cases were liable for the taxes assessed against them, including the deficiency assessments; and, therefore, in my opinion the Tax Court is not free in these or substantially similar circumstances to draw either the contrary conclusion or opposing ones. While it is not strictly necessary to express this opinion in these cases in view of the Tax Court's consistent conclusions of liability, it is inconceivable to me that the two cases, consistently with the federal tax law, could be decided the other way or with different outcomes on the facts presented. Being of this opinion, I consider the failure to state it could only tend to perpetuate a source of possible confusion for the future.